BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 90-266-C - ORDER NO. 90-986
OCTOBER 10, 1990

IN RE:	)	
	)	ORDER DENYING PETITIONS
Generic Proceeding to	)	FOR RECONSIDERATION AND
Consider Intrastate	)	AFFIRMING AND CLARIFYING
Incentive Regulation	)	ORDER NO. 90-849

This matter comes before the Public Service Commission of South Carolina ("the Commission") by virtue of separate Petitions filed by the South Carolina Cable Television Association ("SCCTA") and the Consumer Advocate of South Carolina ("Consumer Advocate") whereby both intervenors ask that the Commission rehear this matter and reconsider its opinion previously issued as Order No. 90-849. As no grounds have been offered in support of rehearing this matter, that request is denied. Upon a review of the Petitions filed, the Commission has decided that it should not reconsider its previous Order, however, the Commission is compelled to clarify certain aspects of Order No. 90-849. Based upon a review of the record and applicable laws, the Order is affirmed, incorporated herein by reference and modified by the findings and conclusions contained herein.

Before addressing the specific allegations of the Petitions before the Commission, it is prudent to set forth the context in which Order No. 90-849 should be placed. That Order does not, in and of itself, allow any telephone utility to increase its rates and charges nor does it allow a telephone utility to reap profits

in excess of that level which would constitute a fair return. Indeed, should a telephone utility wish to either increase rates or its authorized rate of return, it must comply with the statutory requirements of South Carolina Code Section 58-9-540 (Law. Co-op. 1976, as amended). In such an instance, the Commission will continue to adhere to the statutory mandate of Code Section 58-9-570. In short, the regulatory framework within which local exchange companies operate in South Carolina has not been changed by this Order.

Rather, the Commission simply has announced its intent, for local exchange companies to have the opportunity to request regulatory treatment that utilizes a rate of return range within which a utility may conduct its operations in South Carolina. In the past, the Commission has reached a specific rate of return on either equity or rate base, as appropriate, in addressing its legal duty to allow a utility the opportunity to earn a fair return on its jurisdictional investment. That practice of identifying a specific return, however, is not mandated by statute.

Given the undisputed fact that the telephone industry is being driven competitively in applied technology, the Commission remains convinced that the utilities are entitled to receive the opportunity to function somewhat more freely than if the industry remained one of a monopoly provider of all services and that the ratepayers should benefit from this flexibility. In so doing, the Commission has announced this change in policy as a trial. A utility wishing to avail itself of this incentive form of regulation, if granted, may so operate for only a three-year period. Quarterly

and annual reports of earnings will continue to be filed with the Commission. At the end of the trial period, or at any time during the trial period, the Commission, in its regulatory expertise, can either suspend the trial or continue it, depending upon the flow and balance of benefits to the ratepayers and the shareholders.

Having addressed, then, in general terms, the Commission's goal in adopting Order No. 90-849, the specific allegations of the SCCTA and the Consumer Advocate will be addressed. First, the SCCTA asserts that the Commission failed to consider the impact incentive regulation will have on ratepayers and that Order No. 90-849 will allow "monopoly providers to enjoy a rate of return which far exceeds any reasonable return an investor could expect." Petition at page 2. It is obvious that the SCCTA has misread the Order of which they seek reconsideration.

The record before the Commission convincingly supports the establishment of a trial refinement to telephone utility regulation in South Carolina. As stated by AT&T witness Follensbee:

> Changes in the telecommunications industry, such as rapid advancement in technology and the advent of competition in certain markets, warrant the consideration of an alternative to traditional earnings regulation for the LEC's. At its best, traditional earnings regulation fails to reward a company for improving its efficiency and productivity. In the worst instance, traditional earnings regulation can encourage inefficiencies and increase costs in the provision of a LEC's services.

(Tr. Vol. I, p. 93)

The Commission agrees. In any instance in which a telephone utility comes before the Commission, the protection of the using and consuming public is first and foremost in every decision made by it. In adhering strictly to that charge, however, the Commission should not and, indeed, lawfully cannot, abrogate its duty to afford utilities the opportunity to earn a fair return on their investment. As stated by MCI witness Wood, "I think a viable local exchange company is part of the public interest" (Tr. Vol. I, p. 87).

The Commission, in clarifying Order No. 90-849 so that there will be no confusion as to the Commission's intent to consider the impact of incentive regulation on the ratepayer and its intent to provide safeguards for the ratepayers' protection, has determined that certain annual filing requirements should be used as indicators of the impact of incentive regulation on the ratepayers and the opting LEC's. These filing requirements are incorporated herein and attached hereto as Appendix A. In brief, the filing requirements follow the objectives listed by ConTel witness Spencer (Tr. Vol. I, p. 119). The Commission will require the LEC's to annually file information identifying revenues, expenses and investments in utility services. These filing requirements will be required on a total company regulated and intrastate South Carolina regulated basis.

The purpose of these filing requirements is to provide the Commission with information which will allow the Commission to review technological innovations and services and improved operating productivity to determine whether the LEC opting under incentive regulation should be allowed to continue this regulatory treatment or to take any other action, as appropriate.

The SCCTA next argues that "Traditional regulation is the price carriers pay for monopoly or near monopoly power, whether protected by franchise or the product of sheer market power." (Petition at p. 3). That argument is based on incorrect assumptions. The level of competition is increasing within the telephone industry. Competitive alternatives exist for every aspect of a local companies' services. (See, e.g. Tr. Vol. II, pp. 29-30; 44; 77; 82-96; Tr. Vol. I, pp. 61-62; 36) Further, the Commission has not deregulated the local exchange companies. Their earnings, quality of service requirements, non-discrimination edicts, in short, the entire regulatory scheme in South Carolina, has not been changed by Order No. 90-849.

Next, the SCCTA wrongly asserts that competition is not present in the LEC's businesses and that the Commission erred in so finding. Error exists, the SCCTA alleges, due to the absence of empirical data to support claims of competition in the industry. The Commission again disagrees. Just as you need no "study" or derivation of empirical data to know when the sun has risen or set,

you likewise need no "study" or empirical data to know that competition permeates the entire telecommunications marketplace. This Commission, since 1984, has issued over 737 Certificates of Public Convenience and Necessity to carriers of all descriptions who compete directly with the local exchange companies.[1] It is immaterial to the decision to implement, on a trial basis, a slight variance to our past practices, whether the LEC's revenues lost to competition are ten million dollars or one hundred million dollars. The simple fact is that competition, directly, indirectly or in a generic sense, is in South Carolina today and other forms of such competition, e.g. fiber rings, will, in all probability, be here in the future.

It is clear that if telephone utilities are to have the long-term incentive to seek new efficiencies, to seek new services and to modernize their networks, the Commission must afford them some latitude in their ability to strive toward achievement of these goals. The Commission remains convinced that, given the competitive changes within the telecommunications industry, it must

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[1]The SCCTA, in its footnote one, attempts to support its assertion that no evidence of competition exists by arguing, for the first time, that the Commission's taking of judicial notice of its own files as they relate to the issuance of competing authority to carriers other than local exchange companies is improper. As no objection was made at the time of Southern Bell's motion and no exception to our grant thereof was made at trial, the SCCTA's attempt to preclude our consideration of our own files is itself improper. See e.g. Ashley v. State, 196 S.E.2d 501, 502 (S.C. 1973) holding that evidence introduced at trial without objection may not be challenged on appeal.

seek proactive alternatives, within the statutory confines mandated by the Legislature to allow the LEC's the opportunity to deal with such changes. As stated by witness Walker:

> The telecommunications services marketplace is in transition from monopoly to competitive based. Rapidly expanding telecommunications technology, which is available to virtually everyone, is the primary driver of this marketplace change. Under natural monopoly conditions, traditional rate base/rate of return regulation worked well but continued strict adherence to that type of regulation in the face of a changing, increasingly competitive marketplace, in fact, will be detrimental to the consuming public. This is especially true since technology is moving forward at an increasing pace.
>
> Consequently, just as the marketplace is evolving, the regulatory process must also evolve. Unless changes are made, the public switched network will cease to be a viable resource. Refinements to the regulatory process must occur regardless of how successful past regulatory practices have been. Therefore, now is the time to make the regulatory refinements that are in the public interest of the citizens of South Carolina.
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> The ratepayers, the cities and communities, the Commission and the local exchange companies in South Carolina would all receive benefits from a well-designed incentive regulation plan.
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> Likewise, investors are sensitive to regulatory actions which affect telecommunications companies. To the extent that incentive regulation plans work out well and show promise of facilitating long-term efficiencies, investors view this new approach favorably.

Tr. Vol. II, pp. 77-78.

Finally, in its second allegation of error, the SCCTA asserts "... even the presence of purported generic competition is an insufficient basis for deregulating the LEC's." (Petition at p. 5). In an exercise of what can best be described as "judicial/ administrative efficiencies," the Commission has announced a change in its granting of a specific rate of return. The local companies not opting to apply to the Commission under incentive regulation continue to be regulated exactly as they were prior to September 5, 1990. No local company has been deregulated by our order.

Next, the SCCTA introduces what it believes to be a required finding prior to our decision to implement incentive regulation. It argues that because no evidence of deficiencies in service or deployed technology was offered, the Commission cannot reach the conclusion it did concerning the need for a trial of this modification to the regulation of telephone utilities. It states that "... the record offers little but intuition to support alternative regulation." (Petition at page 7). Again, the Commission disagrees.

As set forth in the Findings of Fact herein, the need to allow the local exchange companies some degree of earnings flexibility is vital to the continued viability of those utilities. More and more, profitable revenues are being lost to competitors and it is those revenues that have allowed, historically, local service to be priced below its relevant cost. Under the SCCTA's approach,

this Commission's regulatory role would be relegated to reactive as opposed to proactive in protecting the interests of the local ratepayer. That view of the Commission's responsibility is contrary to its ability to serve the public interest in South Carolina. Given the state of competition and technology, the Commission's regulation of telephone utilities must be refined. As stated by the local companies:

> If regulators do not change the way they regulate the industry, the business risks of the regulated local exchange companies will continue to increase, their earnings will decline significantly, and local rates will have to become self-supporting. This is particularly true in light of the new and improving technologies being brought to the market almost daily.
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> The LEC's ability to respond competitively would be hampered by the traditional regulatory procedures and practices (lack of price flexibility, social pricing, price averaging, cost allocation procedures, time requirements for tariff filings, etc.). The subsidies needed to keep local service affordable will become increasingly vulnerable. Indeed, the competitive pressures on the non-basic services will cause the subsidies to decline and, possibly, disappear.
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> Since the traditional regulatory framework would still be in place, the only recourse for the LEC's to take would be to file for rate relief, and pass its costs on to the fewer and fewer remaining subscribers. Thus, the "cost plus" characteristics of traditional regulation will have an even greater impact on basic local service prices because there will be fewer optional services and fewer customers on which price increases can be placed.

> The current marketplace for telecommunications services and the new technological innovations associated with the provision of telecommunications services have now placed pressure on the industry such that regulatory refinements must occur.

(Tr. Vol. II, pp. 87-88).

In its next alleged basis for the Commission's reversal of its Order No. 90-849, the SCCTA asserts that, because of its order, the Commission is "... moving into completely unchartered waters to allow LEC's to charge excessive rates and thus overearn substantially a fair rate of return." (Petition at p. 7). Again, the substance of Order 90-849 has been misinterpreted. Nothing in that Order allows any telephone utility to charge excessive rates, much less to overearn substantially a fair rate of return. A utility wishing to increase its rates and charges must continue to adhere to all statutory requirements related thereto. Further, as explained in the underlying Order, any utility availing itself of incentive regulation will continue to file quarterly and annual reports of earnings. Annually, the revenues and expenses will be scrutinized to ascertain whether the public may share in the earnings of the utility. It is apparent that the Commission will not lose its regulatory oversight nor its "feel" for the financial position of the utilities it regulates. In any event, however, the Commission has not and will not abrogate its mandate to preserve universal telephone service while, at the same time allowing a utility's investors to earn a fair rate of return.

The SCCTA alleges as further error the Commission's not discussing, in detail, the statutory mandates of S. C. Code Section "58-9-350" (sic). The statute to which the SCCTA obviously meant to refer, Section 58-9-330, states:

> For the purpose of encouraging economy, efficiency and improvements in methods of service any telephone utility may participate, subject to the approval of the Commission, to such extent as may be permitted by the Commission, in the additional profits arising from any economy, efficiency or improvements in methods or service instituted by such telephone utility.

Much of the testimony offered by the parties in this case dealt with the need to offer incentives to the utilities to operate more efficiently. For example, ConTel witness Spencer offered his view of five objectives of any incentive plan:

> An incentive regulation plan should meet the following objectives:
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> 1. Technological innovation: The plan should encourage LEC's to invest in new technology with the goal of providing improved services and lower costs.
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> 2. Introduction of innovative products and services: The plan should provide LEC's the financial incentive to explore and market new products and services.
>
> 3. Financial incentives for improved operating productivity: The plan should provide LEC's with financial rewards for improved productivity leading to reductions in the long-term cost of providing service.
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> 4. Pricing flexibility: In markets where prices are driven by competitive forces, LEC's should be allowed to price services with reduced regulatory oversight.

> 5. Administrative simplicity: The plan should not increase the cost of regulation through excessive monitoring and reporting requirements.

(Tr. Vol. I, p. 119)

Similarly, witness Jensik of GTE testified:

> A modern telecommunications network is critical to the South Carolina economy. By establishing an environment which promotes the development of an advanced communications network a Local Exchange Carrier (LEC) can cut costs, boost overall efficiency and become more productive. Increased productivity leads to a stronger economy, and a stronger economy offers a competitive edge in attracting jobs to South Carolina. A state with a competitive edge will provide its citizens with more jobs and a higher standard of living. Traditional regulation of telephone companies is deficient in providing the correct incentives and therefore will not contribute to the desired competitive condition in the long run.

(Tr. Vol. II, pp. 40-41).

The action of the Commission in this docket is in full concert with the statutory sharing mechanism relied upon by the SCCTA. Competition in the market provided a catalyst for the Commission's decision to investigate the prudency of refining the present regulatory scheme. Competition is not the basis upon which any decision to share in profits will be made.

The decision in this docket, however, does not allow utilities to "share" in profits, as contemplated by 58-9-330. Rather, having established after hearing, a range of return to the investor, the Commission's action allows the ratepayer to share in

the utility's earnings once it reaches a designated point within the allowed range. It is the ability to share in the earnings above a designated threshold of an allowed range that should, over time, spur the companies to improve efficiencies and productivity and adopt a more competitive mindset. This setting of a range of allowed return, then, is complementary to, and not in conflict with, Code Section 58-9-330.

The SCCTA next asserts that the Commission erred in not expressly providing in its plan some means by which it can assure that monopoly services do not subsidize competitive services. The only competent testimony in this regard came from intervenor witness Reynolds who raised concerns about potential cross-subsidies among services. Even he admitted, however, that while such cross-subsidies should not be allowed, they do not exist in South Carolina (Tr. Vol. II, p. 12). In actuality, witness Reynolds advocated that each service offered by a telephone utility pay its own way. There is certainly nothing in the record to suggest that the cross-subsidization of competitive services by local exchange service exists. This Commission has never set rates based upon a service specific rate of return and, in fact, it has expressly rejected suggestions that it do so. See, Docket 82-134-C.

Next, the SCCTA outlines five additional protections the Commission should adopt in its incentive regulation plan.[2] First, it argues that whatever portion of enhanced profits are to be shared by the ratepayers, must be routed to the ratepayers and not to LEC capital projects (Petition at p. 13). The Commission heard numerous suggestions as to how any "excess" earnings should be shared with the public. As stated in Order No. 90-849, "[t]he manner of refunds or sharing revenues would be separately handled for each LEC ... during the proceeding to establish the benchmark." Order, p. 9.

The range established by the Commission for sharing is next alleged by the SCCTA as, in essence, having no upper limit. The Commission disagrees. Staff witness Walsh recommended a total spread of some 350 basis points (Tr. Vol. I, p. 16, Hearing Exhibit One). Witness Jensik proposed a range of some 550 basis points (Tr. Vol. II, pp. 52-54). Clearly then the range established is within the confine of the record and any excess earnings over the established ceiling will flow to the ratepayer. Order No. 90-849, p. 12.

Next, the SCCTA argues that the filing of quarterly and annual reports by jurisdictional telephone utilities operating under incentive regulation is "... simply too long." The SCCTA

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[2]The SCCTA offered no witness(es) at hearing and offered no testimony concerning these "five additional protections" it now asserts on appeal.

points to nothing in the record to support its position in this regard and, in any event, the Commission disagrees. Following each twelve month, historic test period of actual data, the Commission will inquire, under an incentive regulatory approach, into the utility's earnings and deal with such appropriately. (See, e.g. Tr. Vol. I, pp. 22-23). If quarterly surveillance reports reveal some inappropriate level of earnings, the Commission has existing means to "show cause" the utility. In short, the SCCTA position is without merit.

The SCCTA next voices concern about the need to establish sanctions in this docket should a utility disobey a Commission order. The ability to deal with a utility's disobedience already exists. Code Section 58-9-390 requires each utility to obey orders of the Commission and Code Section 58-9-770 provides the procedural mechanisms by which disobedience may be stopped, and Code Section 58-9-1610 provides for the imposition of monetary penalties for failure to obey a lawful Commission order. The inherent and express powers of the Commission to enforce its Orders are sufficient and need not be redefined in this proceeding.

As to the SCCTA's request that a "rate moratorium" be incorporated into any plan, it urges that "... the LEC's ... will enjoy upside potential against a public cushion for failure" (Petition at p. 15). That position is contrary to the evidence. During the SCCTA cross-examination of Staff witness Walsh, the

impact of a rate moratorium at New York Telephone, as discussed in the SCCTA Petition, was debated.

Q. If a situation were to develop in South Carolina with an LEC similar to that which developed with New York Tel under the earnings sharing plan adopted in New York, would the staff recommend that the Commission be permitted to re-enter the picture, if you will, and require that the LEC return to a traditional return on rate base or equity approach to regulation?

A. I think the plan that I have recommended to the Commission takes care of an instance in that case. For instance, a local exchange company that may opt to become incentive regulated, if their benchmark is established at a return on equity of 13 percent, the plan that I have recommended would require that LEC to eat earnings or the loss of earnings down to 12 percent prior to filing any type of rate relief. Now, once the company dropped that 100 basis points below the benchmark, they could then file traditional rate relief, as I understand it.

Q. So am I correct, then, in summarizing your comment that a portion of the loss or a portion of the underearnings, if you will, will be borne by the shareholders of the LEC, but a portion would also be borne by the ratepayers?

A. The portion of underearnings that would be borne by the shareholders would be that deficit of 100 basis points below the authorized return Once it dropped to, let's say 150 basis points, then that in fact could trigger the local exchange company to file a traditional rate case.

Q. Mr. Walsh, if the LEC's come before the Commission and they say, "We want to be

> regulated under an alternative plan" and, if earnings sharing is what is adopted, they come before the Commission and say, "We want to be regulated under the earnings sharing plan," and if the LEC stumbles in the manner that New York Tel stumbled, why should the ratepayers be required to bear any portion of the burden that would result from such a mishap, if you will?
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> A. I think that the actual concept of earnings sharing does what it's supposed to do. If a benchmark is there of 13 percent, the company can retain earnings up to 14 percent, but the company also takes the risk of having to eat earnings below that level down to 12 percent. Whereas if this company was under traditional rate of return regulation, as earnings dropped to 12.5 percent on equity, they could then file a rate proceeding to adjust those rates. So, I feel like there is a sharing there. The company can share in above, but they also take the burden or the risk of their investors not recovering earnings below the level that's authorized by the Commission, down to 100 basis points below.

(Tr. Vol. I, pp. 23-26).

The Commission has spread the risk, as urged by witness Sokol, "Companies entering into this optional regulatory reform plan are agreeing to take the full risk of falling 100 basis points below their authorized rate of return without petitioning for relief" (Tr. Vol. II, p. 149). There is, then, no public cushion for failure as, indeed, should a utility fall more than 100 basis points below its benchmark return, i.e. the bottom of its range, it must invoke the existing statutory scheme found at Code Sections

58-9-520, et seq. and abandon its ability to operate under so-called incentive regulation.

Finally, the SCCTA asserts that the Commission failed to adequately set forth findings and conclusions. While the Commission disagrees, its Order No. 90-849 is modified by this Order and it is incorporated herein by reference. As to the SCCTA's position that certain of its arguments were either not considered or not discussed, the Commission must express confusion. The SCCTA presented no witnesses. They proferred no "issues" for Commission consideration. Nonetheless, each and every "argument" contained in the SCCTA's Petition has been addressed and rejected.

The Consumer Advocate likewise filed a Petition for Rehearing and Reconsideration. As with the SCCTA Petition, those alleged grounds for error will be discussed individually. First, the Consumer Advocate alleges arbitrary and capricious behavior in violation of Titles 58 and 23 of the Code, an abuse of discretion and asserts that Order No. 90-849 violates the Due Process and Equal Protection Clauses of the United States and South Carolina Constitutions (Petition at pp. 1-2). That overly broad allegation of error, without any specific instance as a basis, is simply incapable of response. Indeed, such broad allegations of error are improper and need not be addressed, Smith v. S. C. Dept. of Social Services, 327 S.E.2d 349, 350 (S.C. App. 1980; Pringle v. Builder's Transport, 381 S.E.2d 731, 732 (S.C. 1989). This matter was notic-

ed in accordance with statutory requirements, a hearing was held, cross-examination allowed and, following consideration of the record, an Order was issued adopting an optional, trial basis of regulation for all local exchange companies. No denial of due process or equal protection has occurred.

The Consumer Advocate's position that an empirical study of the level of competition is required as a condition precedent to the adoption of an optional, trial refinement to existing rate of return regulation is also misplaced. The Commission is keenly aware of the level of competition in South Carolina (See e.g. Findings of Fact, Number 10). The existence of competition served as a catalyst for the Commission's decision to consider refinements within the existing statutory scheme. In this docket the Commission has decided, based upon the record and the findings and conclusions separately stated herein, that rather than utilizing a single rate of return in regulating local exchange companies, the Commission will utilize a range of return. Further, a utility operating in this manner must absorb all earnings at the low end of its range but must share with the public, 50/50, those earnings above a designated threshold, but within the range allowed.

The Consumer Advocate asserts that the Commission would allow a utility to venture into speculative competitive areas without exposing the company or its shareholders to any risk. That is not accurate. Should any party feel that the utility is operating

imprudently, then it should bring that specific matter to the attention of the Commission. Additionally, the Commission intends to monitor the utility's operation to attempt to ensure that such imprudence does not occur.

In any event, the local company is not totally insulated from imprudent ventures. A company, should it opt for this means of regulation, must absorb all earnings shortfalls at the low end of its range before it can even attempt to seek rate relief. Even when that rate relief is requested, it must adhere to the existing statutory scheme of Title 58 of the Code and file a rate case. At that time, the mandates of Code Section 58-9-570 will become controlling and the reasonableness of expenses incurred during the appropriate test year will be scrutinized. The consumers' interests are well-protected by the adoption of this regulatory refinement.

The remaining allegations of error focus principally on Code Section 58-9-330 which is discussed, infra, at pages 9 - 12. That discussion need not be repeated. What shall be addressed again, however, is the erroneous conclusion of the Consumer Advocate that Order No. 90-849 permits the sharing of profits for whatever reason they are achieved. It does not.

The Commission is required, both by the Constitutions of the United States and South Carolina and Title 58 to afford jurisdictional utilities the opportunity to earn a fair return on their

investment. The United States Supreme Court's landmark decision in Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), delineated general guidelines for determining the fair rate of return in utility regulation. In the Bluefield decision, the Court stated:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risk and uncertainties but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business generally.

262 U.S. at 692-693.

During the subsequent year, the Supreme Court refined its appraisal of regulatory precepts. In its frequently cited Hope decision, the Court restated its view:

> We held in Federal Power Commission v. Natural Pipeline Co. ... that the Commission was not

> bound to the use of any single formula or combination of formulae in determining its rates. Its ratemaking function, moreover involves the making of 'pragmatic adjustments' (citation omitted) ... Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling (Citations omitted) ....
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> The ratemaking process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case, that regulation does not insure that the business shall produce net revenues. (Citations omitted). But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the Company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividend on the stock. (Citation omitted). By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 602-603.

The vitality of these decisions has not been eroded as indicated by the language of the more recent decision of the Supreme Court in In Re: Permian Basin Area Rate Cases, 390 U.S. 747 (1968). This Commission has consistently operated within the guidelines set forth in the Hope decision and the use of a rate of return range within which a utility may operate is not inconsistent therewith. Within that range of return, however, the Commission

has allowed the ratepayer to share in earnings generated above a designated threshold. The intent is to encourage the utility to operate more efficiently, thereby benefiting the ratepayers. Clearly, the ratepayer is better served under this refinement to the existing regulatory scheme in South Carolina as this trial brings about the Commission's intended objective. As a trial, however, the Commission will evaluate the use of a rate of return range in light of the continued goal of universal telephone service.

The Consumer Advocate also asserts insufficient findings in Order No. 90-849 to support the Commission's use of return on equity as a benchmark return for the local companies. The Commission is somewhat confused by the position taken by the Consumer Advocate in this regard. For as long as the Commission has regulated telephone utilities, the rate of return determination must, by definition, be based on either the total investment of the utility or the equity component thereof. See, e.g. Order No. 85-1 in Docket 84-308-C.

In the record in this proceeding, a difference of opinion was expressed as to whether equity or investment was a better measure of rate of return.[3] GTE urged that a return on investment as opposed to a return on equity was appropriate (Tr. Vol. II, p. 53).

[3]The Commission, sua sponte, takes judicial notice of the fact that some jurisdictional telephone utilities do not even have an equity component to their capital structure.

Southern Bell speaks only in terms of a "rate of return" (Tr. Vol. II, p. 103). United Telephone speaks in favor of using a return on investment (Tr. Vol. II, p. 146). Staff witness Walsh, on the other hand, simply urges that rate of return should be based on the particular method of regulation, i.e. either investment or equity, based upon the manner in which that utility is presently regulated (Tr. Vol. I, p. 13). In any event, the Commission has determined that either investment or equity may serve as the basis for establishing a rate of return and that the specific determination should be made on a case by case basis.

Finally, the Consumer Advocate urges the use of a hypothetical capital structure in regulating telephone utilities. Not only was that issue not raised at trial, a determination of a telephone utility's capital structure is unique and is not properly determined in a generic proceeding.

Having disposed of the specific arguments raised by the SCCTA and the Consumer Advocate, the Commission now must address these parties' requests for a stay of Order No. 90-849 pending the appeal thereof. The granting of a stay is peculiarly within the discretion of the Commission and even when a stay is requested, it is not mandatory that it be granted. See Code Section 1-23-380(c); City of Spartanburg v. Belk's Department Store, 199 S.C. 458, 20 S.E.2d 157 (1942).

In the instant case, neither the SCCTA nor the Consumer Advocate have made any showing of a need to maintain the status quo. Indeed, as Order No. 90-849 does not result in any increased rates and charges to consumers nor does it result in any increase in profits to a utility, a stay of the generic order, which refines the method of regulation of telephone utilities, is not appropriate. Therefore, these requests are denied.

In support of its Order No. 90-849, and in support hereof, the following additional Findings of Fact and Conclusions of Law are asserted.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. Competitive forces have emerged in the telecommunications industry in South Carolina over the last six years (Tr. Vol. I, p. 12).

2. The so-called natural monopoly characteristics of telecommunications are now facing changes. These changes come from expanding technology and the resulting expansion in competition (Tr. Vol. II, p. 82).

3. Since 1984, the Commission has authorized 2 carriers competing authority with the local exchange companies for the provision of access services (Tr. Vol. I, pp. 61-62).

4. Since 1984, the Commission has authorized 31 carriers to resell intraLATA toll and point to point interexchange

services in direct competition with the local exchange companies (Tr. Vol. I, pp. 61-62; p. 36).

5. Since 1984, the Commission has authorized over 700 carriers to offer coin/coinless telephone services in direct competition with the local exchange companies for the provision of such services (Tr. Vol. I, pp. 61-62; p. 36).

6. Competition is emerging in the area of billing and collection services as both the independent telephone companies and third parties construct their own data bases for these services (Tr. Vol. I, p. 46).

7. Interexchange carriers in South Carolina have been granted a "price cap" form of regulation in that so long as they operate below a "maximum rate, no further inquiry is made into their earnings and operations (Tr. Vol. I, pp. 62-63).

8. There is presently a competitive alternative to the LEC's MTS, WATS, 800 and private line services (Tr. Vol. II, pp. 29-30).

9. In the local market, cellular radio, shared tenant services, cable television, fiber optic and alternative access providers have emerged as present and/or potential competitors to the local exchange companies (Tr. Vol. II, p. 44).

10. The telecommunications services marketplace is in a state of transition reflecting more competition (Tr. Vol. II, p. 77), including, but not limited to, the following:

A. Some real estate developers have begun to incorporate telecommunications services as an integral part of the buildings' services. Apartment buildings have master antennas and cabling for broadband services (Tr. Vol. II, p. 44).

B. Duff and Phelps, a credit rating agency has found that almost half of the local exchange companies' revenues are derived from toll and network access services, a dependence viewed with concern as these services are subject to greater competitive pressures (Tr. Vol. II, p. 84).

C. The State of South Carolina has begun "competing" with the local exchange companies by constructing its own private network (Tr. Vol. I, p. 59).

D. Financial institutions have installed their own private networks utilizing "very small aperture terminus" data transmission facilities (Tr. Vol. I, p. 60).

E. While there are presently no fiber rings in South Carolina, they are under construction in Atlanta, Miami and Orlando. As South Carolina is a typical sunbelt state, there is no reason to believe such facilities will not soon be offered in South Carolina (Tr. Vol. II, p. 127).

11. Since traditional regulation no longer has available to it the same set of monopoly services, the only major revenue stream available to support basic service is from the competitive services (Tr. Vol. II, p. 86).

12. Telecommunications technology is advancing rapidly and competitive pressures on non-basic services are increasing steadily (Tr. Vol. II, p. 95).

13. The National Telecommunications and Information Administration, which acts as a policy advisory group to the White House, has indicated that some 39 states have explored the need for some type of regulatory reform (Tr. Vol. II, p. 140).

14. A fundamental purpose of telecommunications policy is to ensure the availability of efficiently produced, affordable, quality telecommunications services (Tr. Vol. II, p. 46).

15. The ultimate goal of the Communications Act of 1934 was, and is, the provision of "Universal Telephone Service" (Tr. Vol. II, p. 78).

16. Of the various regulatory actions taken by other state Commissions, earnings sharing represents only a refinement to traditional rate of return regulation as earnings above a certain level are shared between ratepayers and the utility (Tr. Vol. II, pp. 93-94).

17. Changes in the telecommunications industry, such as a rapid advancement in technology and the advent of competition in certain markets, warrant the consideration of an alternative to traditional earnings regulation of local exchange companies (Tr. Vol. I, p. 93).

18. Incentive regulation involves changes in the rules regarding rates of return; not changing substantially other aspects of rate of return regulation. Instead of setting a single rate of return, regulators set a rate of return band using a floor, a benchmark, a threshold and a ceiling (Tr. Vol. II, p. 51).

19. The current regulatory process should continue as it does now, however, some refinements are required. Refinements designed to encourage the LEC's to become more efficient, while confronting enhanced competition, are necessary if the public interest is to be served (Tr. Vol. II, p. 89). To that end, the Commission has set forth reporting requirements to monitor the efficiencies and to judge the impact of incentive regulation on the LEC and its ratepayers. The reporting requirements are contained in Appendix A and incorporated by referenced herein.

20. If the degree and methods of regulation are not refined, the long-term viability of Universal Telephone Service could be affected (Tr. Vol. II, p. 86).

21. The LEC's are taking the risk of earnings below the benchmark return which would require their shareholders or investors to absorb down to the level at which the utility could file for rate relief (Tr. Vol. I, p. 51).

22. Upon adoption of refinements to the current method of regulation, the Commission will still maintain the same regulatory control that they currently maintain (Tr. Vol. I, p. 49).

23. At the end of a twelve month period, the Commission Staff Accounting Division would audit an opting telephone utility to determine the impact of incentive regulation on that local exchange company (Tr. Vol. I, p. 22).

24. Consumer benefits to a refined regulatory plan include continuation and perpetuation of affordable, quality basic local service provided by a more efficient and productive utility.

25. New product and services should be forthcoming because of the incentives provided and the resulting more rapid deployment of new technologies (Tr. Vol. II, p. 106).

26. Current and evolving technological capabilities are now impacted and will continue to affect subsidies. The Commission has very limited control over this impact because it is driven by the competitive marketplace for the non-basic products and services (Tr. Vol. II, p. 102).

27. Different services provided by the LEC's face different degrees of competition. This is a dynamic situation headed in the direction of more competition and more customer choices (Tr. Vol. II, p. 102).

28. The jurisdictional telephone companies are entitled, as a matter of law, to be afforded the opportunity to earn a fair rate of return on its jurisdictional investment. Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923).

29. The Commission is vested with the power and jurisdiction to supervise and regulate the rates and services of every public utility in this state and to fix just and reasonable standards, classifications, regulations, practices and measurements of service to be furnished, imposed or observed and followed by every public utility in this state. Code Section 58-3-140.

30. The Commission may utilize its experience, technical competence and specialized knowledge in the evaluation of the evidence. Code Section 1-23-330(4).

31. The Rules of Evidence as applied in civil cases in the Court of Common Pleas likewise apply in contested matters before the Commission. Code Section 1-23-330.

32. The incentive regulation methodology represents a refinement to the previous practices of the Commission. The weighing of the evidence and the drawing of the ultimate conclusion therefrom as to what return is necessary to enable a utility to attract capital is a matter peculiarly within the province of the Commission. Southern Bell Tel. & Tel. Co. v. Public Service Commission, 244 S.E.2d 278 (S.C. 1978).

NOW, THEREFORE, having reconsidered the record in the specific context of the issues raised by the SCCTA and the Consumer Advocate,

IT IS ORDERED:

1. That Order No. 90-849 is affirmed and is supplemented by the provisions of this Order including the narrative portion, findings and conclusions hereof;

2. That the Petitioners' request for Stay of the Operation of our Order is denied as no foundation has been laid therefore. Further, under our determination that the refinements to the existing regulatory scheme are in the public interest, a stay of the operation of our Order would be in conflict therewith.

BY ORDER OF THE COMMISSION:

Marjorie Amos-Grogues
Chairman

ATTEST:

Charles W Ballentine
Executive Director

(SEAL)

1. Identify changes in expenses for Total Company Regulated and Intrastate Regulated Operations:

   a. Actual dollar amount of aggregate expenses to include plant non-specific, plant specific, customer operations expense, and total operation expenses.

   b. Supply information in 1(a) to reflect the elimination of annual inflation.

   c. Supply information in 1(a) to reflect the individual expense items by specific account.

   d. Provide a monthly calculation of cost per access line.

2. Identify changes in revenues for Total Company Regulated and Intrastate Regulated Operations:

   a. Actual dollar amount of aggregate revenues to include Local Network Service, Network Access Service, Long Distance, Miscellaneous, Uncollectibles, and Total Operating Revenue.

3. Identify changes in Expenditures for Plant and Equipment for Total Company Regulated and Intrastate Regulated Operations:

   a. Actual dollar amounts to include changes made during the year in accounts representing plant and equipment, according to Uniform Systems of Accounts for Telephone Companies.

4. Each utility must file a verified statement concerning operational efficiencies and any other consumer benefits which it feels have been achieved by virtue of this refinement to the utility's regulatory scheme. For example, a discussion of the investments made to improve efficiencies in operations, including the capital and associated expense savings associated therewith, should be filed.